Senate Budget and Fiscal Review—Denise Ducheny, Chair

SUBCOMMITTEE NO. 4 Agenda

Michael Machado, Chair
Robert Dutton
Christine Kehoe

HEARING OUTCOMES

Wednesday, March 14, 2007
9:30 a.m.
Room 113

Consultant: Brian Annis

Select Business and Transportation Departments, Other

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Departments Proposed for Consent / Vote-Only

2100 Department of Alcoholic Beverage Control

The Department of Alcoholic Beverage Control (ABC) administers the provisions of the Alcoholic Beverage Control Act, which vests in the Department the exclusive right and power to license and regulate the manufacture, sale, purchase, possession, and transportation of alcoholic beverages within the state and, subject to certain laws of the United States, to regulate the importation and exportation of alcoholic beverages into and from the state.

The Governor proposes total expenditures of $51.5 million (no General Fund) and 459.2 positions, – a decrease of $716,000 and no change in positions. The decrease was due to one-time adjustments – no Budget Change Proposals were submitted for the Department.

Action: Approved the budget on a 3-0 vote (a single vote was taken for all three departments on the consent / vote-only calendar).

2120 Alcoholic Beverage Control Appeals Board

The Alcoholic Beverage Control Appeals Board consists of three members appointed by the Governor. The Board provides a forum of appeal to persons who are dissatisfied with the Department of Alcoholic Beverage Control's decision to order penalties or issue, deny, condition, transfer, suspend, or revoke any alcoholic beverage license. Following the filing of an appeal, and submission of written briefs, the Board hears oral arguments in Northern and Southern California on the appropriateness of the Department's decision. The Board then prepares, publishes, and distributes a formal written opinion. A party seeking review of an Appeals Board decision must file a petition for writ of review with the Court of Appeals.

The Governor proposes total expenditures of $1.0 million (no General Fund) and 8.8 positions for the ABC Appeals Board – a decrease of $6,000 and no change in positions. The Administration did not submit any Budget Change Proposals for the ABC Appeals Board.

Action: Approved the budget on a 3-0 vote (a single vote was taken for all three departments on the consent / vote-only calendar).

2310 Office of Real Estate Appraisers

The Office of Real Estate Appraisers (OREA) administers a program for licensing of real estate appraisers in federally-related loan transactions. All appraisals for federally regulated real estate financing transactions must be conducted by persons licensed in accordance with applicable State standards. OREA also investigates complaints against appraisers made by lenders and consumers. In addition, certain appraisals, because of the size of the real property or complexity involved, must be performed only by a state-licensed appraiser.

The Governor proposes $4.2 million (no General Fund) in total expenditures and 26.2 positions for OREA – an increase of $173,000 and no change in positions. The Administration did not submit any Budget Change Proposals for OREA.

Staff Recommendation: Approve the budgets for the above departments.

Action: Approved the budget on a 3-0 vote (a single vote was taken for all three departments on the consent / vote-only calendar).

Departments Proposed for Discussion / Vote

0520 Secretary for Business, Transportation and Housing

The Secretary of the Business, Transportation and Housing Agency (BT&H Agency) is a member of the Governor's Cabinet and oversees 16 departments, including the following departments:

- Alcoholic Beverage Control
- Corporations
- Housing and Community Development
- California Highway Patrol
- Motor Vehicles
- Financial Institutions
- Real Estate
- Managed Health Care
- Transportation

In addition, the Secretary's Office oversees programs, including the following, which are budgeted directly in the Secretary's Office:

- Infrastructure and Economic Development Bank
- Office of Military & Aerospace Support
- Tourism Commission
- Small Business Loan Guarantee Program
- Film Commission

The Governor proposes total expenditures of $27.7 million ($9.5 million General Fund) and 63.6 positions for the Office of the Secretary – an increase of $2.4 million (including a $4.3 million one-time federal fund increase and a $2.1 million General Fund decrease) and 3.0 new positions.

Budget Changes proposed for Consent / Vote Only

1. **Film Commission: Rent Increase (BCP #1).** The Administration requests an ongoing augmentation of $71,000 (General Fund) to cover the cost of a rent increase at the California Film Commission's office in Hollywood. The Agency indicates their lease is expiring and the current rent is $1.52 per square foot. The Department of General Services estimates a new lease in the Hollywood area will likely fall in the range of $2.72 to $3.26 per square foot. The Film Commission is hoping it can negotiate with the landlord to stay in the current facility and avoid moving costs (which are not included in the request).

2. **Tourism Commission: California Welcome Centers (BCP #6).** The Administration requests an ongoing augmentation of $21,000 (Welcome Center Fund) to perform added workload in the Welcome Center Program. This request would increase annual program funding from $55,000 to $76,000. Assembly Bill 1356 (Chapter 296, Statutes of 2004), authorized the establishment of a system of California Welcome Centers to be overseen by the Tourism Commission. A

Center can be operated by a chamber of commerce, local government, or private entity. The operating entities pay fees to the state to cover the State's costs of administering the program. The Agency indicates there are two newly designated Welcome Centers that will bring the statewide total to 13. Welcome Center operators pay annual fees of $5,000 into the special fund to support the Agency's cost of the program. The Agency monitors the operators and provides marketing assistance and materials.

3. **Tourism Commission: Funding Shift (BCP #8).** The Administration requests a reduction of $6.3 million (General Fund) in State funding for the California Travel and Tourism Commission. AB 2592 (Ch. 790, St. of 2006, Leno), allowed for the establishment of fees on certain types of car rentals to generate funding for California tourism marketing. The fees are expected to generate $25.0 million in 2006-07 and $50.0 million in 2007-08. The new fees more than double the Commission's funding, while also saving the General Fund $6.3 million annually.

4. **Administrative Costs: Services Provided by the CHP (BCP #9).** The Administration requests $180,000 (Motor Vehicle Account) to fund the permanent extension of 2.5 limited-term positions at the California Highway Patrol (CHP) that perform administrative work for the Agency. In addition to the 2.5 limited-term positions, the CHP currently has 5.0 permanent positions that also perform administrative functions for the Agency. The 2.5 limited-term positions were added in 2005-06 to address workload related to the transfer of certain Technology, Trade, and Commerce Agency functions to the BT&H Agency. They were made limited-term so the ongoing workload needs could be better .assessed. The CHP has documented activities and hours that indicate a need to continue the 2.5 positions.

Staff Recommendation: Approve all in the budget requests on the above consent / vote-only list.

Action: All issues on the consent / vote-only open list were kept open.

Discussion / Vote Issues:

5. **Technology Trade and Commerce Agency: Closure Costs (BCP #4).** The Administration requests a one-time augmentation of $150,000 (General Fund) to cover the continued close-out costs for the former Technology Trade and Commerce Agency (TTCA). AB 1757 (Ch. 229, St. of 2003, Committee on Budget) eliminated the TTCA and shifted remaining functions to the BT&H Agency and other departments. The BT&H Agency assumed certain close-out obligations of TTCA, such as legal fees, ongoing workers' compensation payments, etc. The 2004 Budget Act appropriated $575,000 (General Fund) for this purpose. The BT&H Agency reports that only $231,000 was expended in 2004-05, but $30,000 was expended in 2005-06, and the Agency expects to expend $70,000 in 2006-07.

   Staff Comment. The Administration indicates that the $150,000 requested for 2007-08 is the anticipated total closeout cost, which assume all workers' compensation cases will be fully settled or otherwise closed in the budget year. However, it is most likely some workers compensation costs will continue for several years. The likely expenditures for 2007-08 are more in the neighborhood of $70,000.

   Staff Recommendation: Approve funding of $70,000 (a reduction of $80,000 from the BCP) which ties to the estimated 2007-08 cash need.

Action: Issue kept open.

6. **Motor Vehicle Account – Fund Condition (Informational Issue).** The Administration is requesting approval for California Highway Patrol (CHP) and Department of Motor Vehicles (DMV) budget augmentations that will total several hundred million dollars over a six-year period. Staff asked the Agency to demonstrate, with a long-term Motor Vehicle Account (MVA) fund condition statement, whether these augmentations can be sustained without a fee increase. The long term MVA fund condition statement is still pending from the Administration.

   LAO Comment: In the *Analysis of the 2007-08 Budget Bill*, the Legislative Analyst indicates the MVA is likely to face significant shortfalls beginning in 2009-10, and possibly sooner depending on the timing of a number of pending spending initiatives as well as potential risks.

   Staff Comment: The Subcommittee may want to ask the LAO to summarize their findings and ask the Administration to comment.

   Staff Recommendation: Keep issue open pending receipt from the Administration of a long-term Motor Vehicle Account fund condition statement. The Subcommittee may want to keep open DMV and CHP budget requests that would result in large out-year costs.

Action: Issue kept open. The Agency hopes to provide the MVA information by the end of the week.

7. Small Business Loan Guarantee Program: Match for Federal Funds (BCP #7). The Governor requests a one-time appropriation of $832,000 General Fund to match $3.6 million in federal funds to establish a new loan guarantee program that would primarily use federal funds associated with the Sudden and Severe Economic Dislocation (SSED) Program. (Note, the Administration has reduced its estimate of available federal funds from $4.1 million in the BCP to $3.6 million now). The Administration indicates that the Technology, Trade, and Commerce Agency (TTCA), which was abolished in 2003, administered a Sudden and Severe Economic Dislocation Grant Program as a revolving loan program. With the demise of the TTCA, the federal money remains, but cannot be accessed without a General Fund match and a new agency home. The new program would provide loan guarantees to small businesses in areas affected by natural disaster or the loss of jobs from a major employer.

Background / Detail. The Small Business Loan Guarantee Program is administered by 11 non-profit Financial Development Corporations (FDCs). The state pays the FDCs for their administration of the program, under contractual agreements with each FDC. In recent years, the annual budget has included a $3.9 million General Fund appropriation for administrative payments to FDS. The Agency's costs of oversight have been funded through interest earnings. The proposed funding in this BCP is above the base $3.9 million in General Fund support. According to the information provided by the Administration, the current Small Business Expansion Fund fund balance is in the range of $4.6 million, while the balance of the trust fund (which backs the loan guarantees) is about $40 million. The interest earnings from these two funds also support program administration. The combined interest earnings have increased from about $870,000 in 2005-06 to an estimated $1.67 million in 2006-07 and 2007-08. Additionally, a one-time interest payment of $1.1 million was received in 2006-07 related to a past loan to the General Fund. The Agency indicates that interest earnings are expected to continue at a higher level due to a larger trust fund balance (due to repayment of the General Fund loan) and higher interest rates.

Staff Comment: The Agency has used the higher interest earnings (about $800,000 ongoing) to expand the program in 2006-07 by providing additional administrative payments to the FDCs, and would like to continue using the ongoing earnings to run an expanded program. Given that the General Fund is constrained for 2007-08, the Subcommittee may want to consider using the interest earnings as a match for the $3.6 million in federal funds, instead of providing new General Funds.

Staff Recommendation: Keep issue open. Direct staff to continue to work with the Administration and the LAO to explore alternatives to the General Fund for the federal-fund match.

Action: Issue kept open.

8. **Small Business Loan Guarantee Program: Audits (BCP #3).** The Governor requests an augmentation of $125,000 General Fund (each year for two years) to contract with the Department of Finance to audit the 11 Financial Development Corportations (FDCs) in the Small Business Loan Guarantee Program.

Background / Detail: When the Small Business Loan Guarantee Program was housed in the Technology Trade and Commerce Agency and had a larger staff, State personnel performed annual audits of FDCs. The positions that performed these audits were lost when the function moved to BT&H, and only about two audits can be performed per year with current staff. The Agency requests two-year funding totaling $250,000 so that all FDCs can be audited by the Department of Finance over the next two years.

Staff Comment: A fund condition statement for the Small Business Expansion Fund indicates a reserve of $4.1 million at the end of 2007-08. The Agency indicates $3.2 million of this balance is reserved for short-term disaster assistance. It appears that the costs of the audit could be funded by the Small Business Expansion Fund instead of the General Fund.

Staff Recommendation: Approve new funding of $125,000 (each year for two years) to perform audits, but change the funding source from the General Fund to the Small Business Expansion Fund.

Action: Issue kept open.

9. International Trade Activities (BCP #L-1). The Governor requests three new permanent positions, 2007-08 funding of $591,000, and ongoing funding of $441,000, to undertake international trade and investment activities. The Administration indicates this request is associated with SB 1513 (Chapter 663, Statutes of 2006, Romero) which, among other provisions, requires the BT&H Agency to complete a study on the role of the state in global markets, develop a strategic international trade and investment plan, convene a statewide partnership to advise the Secretary on the strategic plan and needs of businesses, and study the feasibility of international trade offices. The report is due to the Legislature by February 1, 2008.

Background / Detail: The Technology, Trade and Commerce Agency was eliminated in 2003 and its positions related to international trade were eliminated. The BT&H Agency has assumed some of these international trade activities, although it has never received new staff for this purpose.

Staff Comment: Committee bill analyses for SB 1513 indicated a cost to perform the planning and report requirements of $70,000 in 2006-07 and $70,000 in 2007-08. The Agency indicates it has absorbed the 2006-07 cost. The BT&H Agency indicates it did not release a bill analysis for SB 1513. The Agency has never received positions to staff workload related to international trade, but indicates it has redirected three positions internally and borrowed one position from Caltrans. The BCP request would officially create the international trade positions and allow redirected positions to return to their original functions.

Staff Recommendation: Reject the BCP. The Agency has absorbed the cost of the study in 2006-07 and can likely absorb the 2007-08 cost. The Agency has four redirected staff positions currently working on international trade. It seems premature to permanently add three new trade positions prior to the development of the strategic plan and legislative consideration of the February 2008 report.

Action: Rejected the BCP on a 3-0 vote.

2150 Department of Financial Institutions

The Department of Financial Institutions (DFI) was established effective July 1, 1997, to regulate depository institutions, including commercial banks, savings associations, credit unions, industrial loan companies, and certain other providers of financial services. In addition, the Department licenses and regulates issuers of payment instruments, including companies licensed to sell money orders and/or travelers' checks or licensed to engage in the business of transmitting money abroad, and business and industrial development corporations. Programs are supported by assessments of the various industries, license and application fees, and charges for various other services.

The Governor proposes total expenditures of $28.5 million (no General Fund) and 224.1 positions - an increase of $2.4 million and 13.7 positions.

Issues Proposed for Consent / Vote-Only

1. **E-Banking / Disaster Preparedness (BCP #2).** The Governor proposes to augment the budget by $1.2 million and 10 positions (eight Examiners, one Office Technician, and one Financial Institutions Manager) to expand bank examinations in the areas of electronic banking (e-banking) and disaster preparedness. The Administration indicates that California's oversight in these areas is deficient relative to other states.

   Background / Detail: The Department indicates that the Conference of State Bank Supervisors (CSBS), who provide a nationwide accreditation of state financial institution regulatory bodies, in their Accreditation Report of DFI, criticized DFI for not having sufficient staff to conduct information technology (IT) examination activities for licensees and Technology Service Providers. CSBS noted that California is one of few states where IT examination activities are left to the federal regulators. According to the Administration, the states of Illinois and New York have a pool of trained IT/E-Banking examiners that are similar in organization and operation to this request.

Action: Approved BCP on a 2-1 vote with Senator Dutton voting no.

2. **Credit Union Program: Business Loan Exams (BCP #3).** The Governor proposes to augment the budget by $247,000 and 2.0 Senior Financial Institution Examiner positions to meet the increased examination needs arising from a significant increase in the number and amount of member business loans being carried on the books of California State-charted credit unions.

   Background / Detail: Historically, credit unions have focused primarily on *consumer* loans. The Department indicates that credit unions have become increasingly more involved in making *commercial* loans to their members. The commercial loan assets have increased from $800 million in December 2000 to $4.3 billion in March of 2006. According to the Department, industry standards suggest 20 percent to 25 percent of these loans should be examined versus the average of 3 percent to 5 percent DFI is currently performing.

Action: Approved BCP on a 3-0 vote.

3. **Special Licensee Program: Staffing (BCP #4).** The Department requests a total of $95,000 (special fund) and one Financial Examiner Position to address the growth in the money transmission industry. This Program examines financial institutions that sell payment instruments (money orders), travelers' checks, and transfer money internationally.

   Background / Detail: The Department indicates the number of money transmission branches has grown from 13,852 in 2000 to 20,439 in 2005. Additionally, the number of special licensees has grown from 52 in 1996 to 73 today. The department indicates it has used 4,256 hours of retired annuitant hours over the past two years to perform this workload.

Action: Approved BCP on a 2-1 vote with Senator Dutton voting no.

4. **Administration: Personnel Position (BCP #5).** The Governor proposes to augment the budget by $137,000 (special fund) to add an Associate Personnel Analyst position and contract out for written test development. The Department indicates the position is necessary to effectively recruit and retain new staff, update job analyses, and conduct background checks of new hires.

   Background / Detail: The Department indicates that in addition to addressing workload increases related to higher staffing and existing administrative backlogs, this position would work on recruitment and retention issues for Financial Examiners. The Department hopes efforts in this area could reduce turnover and therefore reduce training and other costs associated with new Examiners.

Action: Approved BCP on a 2-1 vote with Senator Dutton voting no.

Staff Recommendation: Approve the above consent / vote-only issues.

Issues proposed for Discussion / Vote:

5. **Information Technology (IT): Staffing (BCP #1).** The Governor proposes to augment the budget by $377,000 (special fund) to establish a Chief Information Officer (CIO), an Information Security Officer (ISO), and an Office Automation Support Supervisor.

   Background / Detail. The Department indicates it currently has a designated CIO and ISO; however those positions are also responsible for other administrative, IT user support, and IT maintenance functions. The Department believes the creation of three additional positions, which would increase the number of IT positions from 11 to 14, would allow the new incumbents to focus on individual areas of IT strategic planning, IT security, and management of day-to-day IT operations and support.

   Staff Comment. The benefit of a dedicated CIO and dedicated ISO is easier to justify at large departments, such as Motor Vehicles, or Transportation, that have many ongoing large IT projects, many locations, and many users. The benefit is harder to justify with smaller departments with no reportable IT projects, few locations, and relatively few users. Staff questioned several smaller departments with several hundred or fewer employees, and most did not have dedicated CIO and ISO positions. While the Department may have a workload justification for one new position, and perhaps a position upgrade, it is unclear that all departments of the size and IT complexity of DFI should have dedicated CIO and ISO positions.

   Staff Recommendation. Keep this issue open. There are likely to be further discussions on statewide IT policy in the Subcommittee. Those discussions may provide additional insight on IT staffing for medium to small departments.

Action: Issue kept open.

2180 Department of Corporations

The Department of Corporations (Corporations) administers and enforces State laws regulating securities, franchise investment, lenders, and certain fiduciaries. The budget is divided into two operating programs. The Investment Program is responsible for the qualification of the offer and sale of securities in California and the licensing and regulation of broker-dealers and investment advisers. The Lender-Fiduciary Program licenses and regulates California finance lenders, mortgage lenders, escrow agents, deferred deposit transaction entities (including "payday" lenders), and check sellers.

The Governor proposes total expenditures of $33.9 million (no General Fund) and 277 positions, an increase of $553,000 and 2 positions. The State Corporations Fund has an outstanding loan of $18.5 million to the General Fund from the 2002-03 budget. The Administration proposes to repay $6.0 million on June 1, 2007. With this 2006-07 repayment, the Governor's Budget indicates the State Corporation Fund would end 2007-08 with a reserve of $10.6 million (excluding the remaining General Fund loan of $11.5 million).

Issues for Discussion / Vote

1. **State Corporations Fund – Excessive Fund Balance.** Pursuant to the requirements of SB 742 (Ch. 118, St. of 2001, Escutia), the Department is required to reduce the fund balance in the State Corporations Fund to no more than a 25 percent reserve above annual expenditures by June 30, 2007. According to the Governor's Budget, the Department will have a fund balance of $15.1 million on June 30, 2007, which represents 45 percent of 2006-07 expenditures. SB 742 also requires annual November 1 reports to the Legislature on fee levels and the projected fund balance. The 2006 report has not, to date, been submitted.

   LAO Comment. In the *Analysis of the 2007-08 Budget Bill*, the Legislative Analyst withholds recommendation on the Department's budget pending a report on fees at the budget hearing because the Department has not submitted the SB 742 report. The LAO indicates that, generally, a 5-percent fund balance is a prudent reserve. The LAO also notes that fine and penalty revenue, unlike fees, can be transferred to the General Fund. A transfer to the General Fund of $1.5 million was approved in the 2004 Budget Act; however, no transfers have been made since then. The Legislature may want to consider amending the budget bill to transfer 2005-06 and 2006-07 fine and penalty revenue to the General Fund.

Administration Response to the LAO: The Administration indicates it is withdrawing the proposal in the Governor's Budget to repay $6.0 million of the outstanding $18.5 million General Fund loan on June 30, 2007. This would bring the projected fund balance on June 30, 2007, to $9.1 million – about 27 percent of expenditures. However, the Department also indicates that 2006-07 fine and penalty revenue has exceeded the budgeted amount by about $2.7 million, which would make the June 30, 2007, fund balance about $11.8 million (about 36 percent of expenditures).

Staff Comment: The Subcommittee may want to ask the Department to describe their plan to bring their fund balance in compliance with statute.

Staff Recommendation: Keep this issue open pending receipt of the report.

Action: Issue kept open. The Department will provide the report soon.

2. California State Auditor January 2007 Report. In January, the State Auditor released an audit titled: *Department of Corporations: It Needs Stronger Oversight of Its Operations and More Efficient Processing of License Applications and Complaints*. Among other findings, the audit revealed flaws in Department statistics and data gathering processes, and delays in resolving complaints, performing examinations, and processing applications. A copy of the Auditor's highlights is Attachment I to this agenda.

***2006-2007 Governor's Budget Summary* Comment.** Last year's Governor's Budget Summary included the following comment on the audit:

The DOC will be the subject of an extensive audit by the Bureau of State Audits in 2006 due to various consumer complaints that originated during prior administrations. The Administration will monitor the audit's progress, and at its conclusion, the Administration will work with the Business, Transportation, and Housing Agency and with the DOC on ways to ensure the DOC is able to fulfill its mission of enforcing financial services laws, and protecting the public from fraud.

Suggested Questions: The Subcommittee may want to ask the Department to respond to the following audit findings/recommendations that relate to budget issues:

1. The Department has flawed data collection processes and systems that result in unreliable information on the number, status, and type of complaints. The Auditor also found enforcement data unreliable. Is the Department exploring the Auditor's recommendation to assess the need for new automated data systems? If a new IT system is being considered, what is the timeline for implementation and budget approval?
2. The Department has not, contrary to law, conducted at least 170 (37 percent) of its required examinations of escrow office licensees within the last four years. In addition, it has yet to conduct examinations for 899 (35 percent) of eligible

finance lender licensees within its four-year goal. The Auditor found cases of long delays in processing applications and resolving complaints. Is the Department exploring the Auditor's recommendation to assess the need for additional staff? If new positions are being considered, what is the timeline for implementation and budget approval?

3. What other actions is the Department considering, budget or otherwise, to respond to audit findings and recommendations?

Staff Recommendation: Keep issue open. The following two agenda issues are Department budget change requests for 2007-08. The audit may assist the Subcommittee in assessing the need and adequacy of these budget requests. Staff recommends keeping these requests and the issue of the audit open for further review.

Action: Issue kept open. The Chair asked the Administration to develop a plan this year to address the deficiencies outlined in the audit. The Department will also share response letters to the Bureau of State Audits.

3. **Lender-Fiduciary Program: Convert 3 Limited-Term Examiner Positions to Permanent (BCP #2**). The Legislature approved BCP #3 for 2005-06, which added 16 additional Examiners (7 of these were limited-term) to the Lender-Fiduciary Program. The Administration is requesting to permanently continue 3 of the 7 limited-term positions. However, the workload data from the Department suggests a total of 6 positions (3 more than requested) would be needed to perform all the anticipated 2007-08 workload. The Department indicates fewer positions than the stated need are being requested because it is hoped that a higher proportion of trained staff will increase efficiencies.

Staff Comment: The Audit found that Corporations did not conduct examinations of 170 licensed escrow offices within the statutorily-required timeframe and did not conduct examinations of 899 licensed finance lenders within its four-year goal. Given the examination deficiencies outlined in the Auditor's report, and the resulting gaps in consumer protection, the Subcommittee may want to consider whether it would be appropriate to double the request – and provide six, instead of three, new permanent positions. Note, a total of six new positions are needed to meet the workload need as outlined in the budget change proposal.

Staff Recommendation: Leave issue open and direct staff to work with Corporations to further review the level of Examiner staffing.

Action: Issue kept open. The Chair asked the Administration to develop a plan this year to address the deficiencies outlined in the audit.

4. **Investment Program: Add 2 New Staff Service Analysts (BCP #1**). The Administration is requesting to add 2 new Staff Service Analyst positions. These positions would perform analytical duties currently performed by Examiner positions, and thereby allow the Examiners to spend additional time in the field. The workload data from the Department suggests a total of 34.3 positions (32.3 more than requested) would be needed to perform all the anticipated 2007-08 workload. The Department indicates fewer positions than the stated need are being requested because it wants to further assess efficiencies to get a clearer picture of the true ongoing workload and future staffing needs.

   Staff Comment: Given examination deficiencies outlined in the Auditor's report, and the resulting gaps in consumer protection, the Subcommittee may want to consider whether it would be appropriate to add positions beyond the Adminstration's request. Note, a total of 34.3 new positions are the actual workload need according to the workload data in the budget change proposal.

   Staff Recommendation: Leave issue open and direct staff to work with Corporations to further review the level of Examiner staffing.

Action: Issue kept open. The Chair asked the Administration to develop a plan this year to address the deficiencies outlined in the audit.

5. **Investigator Positions (Staff Issue**). In 2003-04, Corporations eliminated all 14.0 of its Investigator positions as part of the 2003 Budget Act Control Section 4.10 process which required a statewide reduction of 16,000 permanent positions, as specified. Newspaper reports indicate that the cases the Department referred for criminal prosecution declined from 27 in 2002 to none in 2004. Without Investigator positions, this function falls to local law enforcement and the State Attorney General, who received no additional funds to perform this activity. Since the elimination occurred through Control Section 4.10, the Legislature did not consider this reduction through the Budget Subcommittee process. Last year, this Subcommittee re-classed three positions to reestablish the investigative function at the Department.

   Staff Comment: The audit indicates that as of January 2, 2007, Corporations did not have any Investigator positions filled; however, conditional offers were outstanding to three individuals. The Subcommittee may want to ask the Administration about their progress filling these positions and when they will come forward with a long-term staffing proposal for Investigators.

   Staff Recommendation: Leave issue open and direct staff to work with Corporations to further review the level of Investigator staffing.

Action: Issue kept open. The Chair asked the Administration to develop a plan this year to address the deficiencies outlined in the audit.

6. **Payday Lending Survey: (Staff Issue**). Section 23057 of the Financial Code requires the Corporations Commissioner to report to the Legislature by December 1, 2007, on the deferred deposition transaction industry, also know as "payday lending." The purpose of this report is to inform the Governor and the Legislature regarding potential legislation the Commissioner deems necessary to protect the people of California. To collect data for this report, the Department is currently surveying licensees.

   Since the Department is surveying licensees, but not customers, the report will provide a better picture of supply than demand for payday loans. The Department indicates that since it is not performing, or contracting for, a customer survey, it will not be able to include demographic characteristics such as race, income and education in its report. Nor, will it be able to find out if borrowers are obtaining multiple loans from different licensees simultaneously.

   Staff Comment: The Subcommittee may want hear additional detail from the Department on what the report will include and exclude. The Department should be prepared to discuss how much a consultant survey of payday borrowers would cost and how long it would take to procure such a study.

   Staff Recommendation: Leave issue open and direct staff to work with Corporations to develop options to improve, or supplement, the payday-lending report.

Action: Issue kept open. The Department indicated it will share its scoping document for the consumer survey and keep the Subcommittee apprised of its progress.

7. **Guidance on Non-Traditional Mortgage Product Risks (Informational Issue).** In response to the increased marketing of nontraditional mortgage products to a wider variety of borrowers and the increased amount of credit risk layering associated with the marketing and underwriting of these products, the five federal banking agencies developed guidance to address issues of risk management and appropriate consumer disclosure. The September 2006 guidance directs that management should:

   - Ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower's repayment capacity;
   - Recognize that many nontraditional mortgage loans, particularly when they have risk-layering features, are untested in a stressed environment. These products warrant strong risk management standards, capital levels commensurate with the risk, and an allowance for loan and lease losses that reflects the collectibility of the portfolio; and
   - Ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.

In November 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued guidance substantially similar to the federal guidance, but deleted sections of the federal guidance that were inapplicable to non-depository institutions. The CSBS/AARMR guidance is intended to be adopted by states and used by state regulators who oversee state-licensed mortgage lenders and brokers.

Background / Detail: Three State departments regulate residential mortgage lending and brokering activities in California – the Department of Financial Institutions (DFI), Department of Corporations (Corportations), and the Department of Real Estate (DRE). Because virtually all of DFI's bank and credit union licensees are federally-insured by either the Federal Deposit Insurance Corporation or the National Credit Union Administration, virtually all of DFI's bank and credit union licensees are already covered by the interagency federal guidance issued in September 2006. DRE is discussed in a separate budget issue below. Corporations oversees two laws that authorize businesses to engage in residential mortgage lending and brokering - the California Finance Lenders Law (CFLL) and the California Residential Mortgage Lending Act (CRMLA).

Staff Comment: The Subcommittee may want to hear what action Corporations is taking to develop regulations to apply the CSBS/AARMR guidance to its licensees?

Staff Recommendation: Keep this issue open for further analysis.

Action: Issue kept open. The Department indicated it is working on regulations and will keep the Subcommittee apprised of developments.

2320 Department of Real Estate

A primary objective of the Department of Real Estate is to protect the public in real estate transactions and provide related services to the real estate industry. The Department services a licensee population of approximately 525,000.

The Governor proposes $46.6 million (no General Fund) in total expenditures and 336.5 positions for the Department – an increase of $1.6 million and no change in positions. The Administration did not submit any Budget Change Proposals for the Department.

Issues for Discussion / Vote

1. **Guidance on Non-Traditional Mortgage Produce Risks (Informational Issue).** In response to the increased marketing of nontraditional mortgage products to a wider variety of borrowers and the increased amount of credit risk layering associated with the marketing and underwriting of these products, the five federal banking agencies developed guidance to address issues of risk management and appropriate consumer disclosure. More detail on the September 2006 guidance is included in "Issue #7" in the above section for the Department of Corporations.

   In November 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued guidance substantially similar to the federal guidance, but deleted sections of the federal guidance that were inapplicable to non-depository institutions. The CSBS/AARMR guidance is intended to be adopted by states and used by state regulators who oversee state-licensed mortgage lenders and brokers.

   Background / Detail: DRE licenses real estate brokers, who are allowed to make or arrange real estate loans and to sell or service mortgage notes. Most of the residential mortgages facilitated by real estate brokers operating under the Real Estate Law involve loans made by finance lenders, residential mortgage lenders, banks, credit unions, and thrifts, although a smaller number of loans facilitated by real estate brokers are privately funded directly (i.e., not through the secondary market) by individuals or groups of individuals. Some loans arranged by real estate brokers are also made through the brokers' own funds.

   Staff Comment: The Subcommittee may want to hear from DRE on what action the Department is taking to develop regulations to apply the CSBS/AARMR guidance to its licensees.

   Staff Recommendation: Keep the DRE budget open for further analysis.

Action: Issue kept open. The Department indicated it is working on regulations and will keep the Subcommittee apprised of developments.

2400 Department of Managed Health Care

The Department of Managed Health Care (DMHC) was established in 2000, when the licensure and regulation of the managed health care industry was removed from the Department of Corporations and placed in a new, stand-alone, department. The mission of DMHC is to regulate, and provide quality-of-care and fiscal oversight for Health Maintenance Organizations (HMOs) and two Preferred Provider Organizations (PPOs). These 94 Health Care Plans provide health insurance coverage to approximately 64 percent of all Californians. Recent statutory changes also make DMHC responsible for the oversight of 240 Risk Bearing Organizations (RBOs), who actually deliver or manage a large proportion of the health care services provided to consumers. Within the Department, the Office of the Patient Advocate helps educate consumers about their HMO rights and responsibilities.

The Governor proposes $43.5 million (no General Fund) in total expenditures and 297.3 positions for the department – an increase of $72,000 and no change in positions. The Administration did not submit any Budget Change Proposals for the Department.

Issue for Discussion

1. **Mental Health Parity Report (Staff Issue).** The Department is expected to release a report on mental health parity issues over the next several weeks.

   Background / Detail: The DMHC is responsible for ensuring that health care service plans including health maintenance organizations (HMO) and preferred provider organizations (PPO) comply with California's mental health parity law (AB 88, Chapter 534, Statutes of 1999), which became effective in 2000. Through the Budget Act of 2004, the Legislature requested the Department of Mental Health to collaborate with DMHC, the Department of Insurance, and representatives from the California public and private mental health systems to produce a report analyzing the implementation of mental health parity in California. Issued in 2006, the report identified several barriers to full implementation of mental health parity including barriers related to access and covered services. The report also contained recommendations for addressing these issues; many recommendations were directed to DMHC.

   Legislative staff questioned DMHC about their response to the recommendations. In December 2006, DMHC staff indicated that the issues would be addressed in a forthcoming report on mental health parity that was initiated by DMHC. The report would reflect a more detailed review of parity implementation, including perspectives of health plans and findings from follow-up surveys of the plans.

Suggested Questions: The Subcommittee may want to ask the DMHC the following questions related to mental health parity:

1. Will the forthcoming DMHC report on mental health parity address all of the issues and recommendations directed to DMHC in last year's report on mental health parity?
2. What, if any, steps has DMHC taken to implement the recommendations?
3. When will the report be released?

Staff Recommendation: Keep the Department's budget open pending receipt of the mental health parity report.

Action: Issue kept open. The Department provided the report at the hearing. Legislative staff will review the report and bring this issue back as warranted.

2740 Department of Motor Vehicles

The Department of Motor Vehicles (DMV) regulates the issuance and retention of driver licenses and provides various revenue collection services. The DMV also issues licenses and regulates occupations and businesses related to the instruction of drivers, as well as the manufacture, transport, sale, and disposal of vehicles.

The Governor proposes total expenditures of $902.8 million (no General Fund) and 8,280.1 positions, an increase of $19.2 million (2 percent) and a decrease of 24.1 positions.

Issues Proposed for Consent / Vote-Only

1. **International Registration Plan Audit Program (BCP #7).** The Administration requests $98,000 and the redirection of 5.0 positions to comply with the audit requirements of the International Registration Plan (IRP), of which California is a member. The IRP is a registration reciprocity agreement among 59 jurisdictions, including 48 states and 10 provinces in Canada. Under IRP, jurisdictions must audit a minimum of 3 percent of fleets registered in their jurisdictions. If California does not meet the audit requirement, the IRP may withhold transfer of weight fee payments that other jurisdictions have collected from their fleets on behalf of California (for miles traveled in California). There is a net cost to this proposal because the redirected positions are technicians being reclassed as auditors (at a higher pay range).

Staff Recommendation: Approve the above consent / vote-only issues.

Action: Approved BCP on a 3-0 vote.

Issues for Discussion / Vote

2. **Federal REAL ID Act – Draft Regulations.** On May 11, 2005, President Bush signed H.R. 1268, which includes the Real ID Act of 2005. Draft regulations from the federal government on the implementation of this law were released on March 1, 2007. Last year, the DMV estimated implementation of Real ID may cost the State $500 million to $750 million. Real ID will cause inconvenience for California driver license holders, because most people will have to go to a DMV field office to re-verify their identity. Real ID requires people without a passport to have a compliant driver's license or identification card in order to enter a federal building or cross an airport checkpoint.

Background / Detail: Last year the Administration submitted, and the Legislature approved, $18.8 million for information technology improvements and planning activities to improve DMV's customer service and data collection – all related to Real ID. The Legislature added budget bill language specifying that the funding did not implement Real ID for California, but rather improved efficiencies at the DMV to facilitate implementation at a later date, should enacting legislation be approved. The budget bill language included two reports. The first requirement was for DMV to update the expenditure detail for the $18.8 million prior to expenditure of the second half of the amount – this report was submitted on February 13, 2007. The second report requires DMV to report on the federal regulations. This report has been postponed due to the delays in the federal regulatory process, and the final regulations are still at least two months away. The DMV indicates it will provide overview information on the *draft* regulations within the week.

Draft Federal Real ID Regulations: The following information is from the draft regulations and summary information from the Department of Homeland Security (DHS):

- States may delay implementation of Real ID from May 11, 2008 to January 1, 2010, upon approval from DHS.
- The full phase-in deadline for current license-holders to obtain compliant ID is May 10, 2013. (Assuming an extension is granted to California, this means a large portion of 22 million California license holders will have to re-verify their identity at a DMV field office over a 40-month period).
- DHS will enable States to use up to 20% of a State's Homeland Security Grant Program funds for REAL ID compliance efforts, beginning in the current year. (No *new* federal funds will be available to states for Real ID).
- The mandated machine-readable technology for ID cards will be "2-D barcodes."

Staff Comment: The Governor's Budget includes $8.7 million for Real ID planning in 2007-08 that relates to second-year activity for BCP's approved last year. The Administration did not submit any BCPs directly related to Real ID, but several of the proposals are indirectly related. The Administration anticipates the submittal of spring Finance Letters related to Real ID.

Staff Recommendation: Keep issue open for further discussion.

Action: Issue kept open for further discussion.

3. **New Leased Facilities (BCP #4).** The Administration requests 2007-08 funding of $9.6 million ($4.7 million ongoing) to remove non-public programs out of field offices and into stand-alone leased facilities or consolidated leased facilities. The DMV indicates these changes would reduce overcrowding in field offices, and also be beneficial in addressing a surge in visits that would accompany the implementation of Real ID.

Background / Detail. The DMV indicates it is pursuing a strategy of "customer segmentation" to improve customer service and efficiency. Under this strategy, certain DMV employees that do not deal face-to-face with the general public will be moved out of field office locations to standard lease space. In turn, this action would free up additional space at field offices to add customer service staff and terminals. Additionally, less-common customer transactions, such as business services and driver safety hearings would be moved out of DMV field offices. The new leased facilities and costs are outlined in the table below (dollars in 1,000s):

	2007-08	**On-Going**
Consolidated Telephone Centers (One new location)	$5,475	$2,297
Business Service Centers (Three new locations)	$2,986	$1,745
Driver Safety Hearing Offices (Two new locations)	$917	$624
Dept. of General Services Fees	$250	$0
TOTAL	**$9,628**	**$4,666**

Staff Comment: The customer segmentation strategy may be desirable to service a growing California population while minimizing new field offices; however, the short-term motivation is preparing for the surge in field office visits that will happen with Real ID.

Staff Recommendation: Keep open pending additional information and discussion on Real ID.

Action: Issue kept open.

4. **Capital Outlay – Office Reconfigurations (CO BCPs 2.1, 2.3, & 2.5).** The Administration requests a total augmentation of $8.6 million in Motor Vehicle Account funds to reconfigure three existing DMV field offices (Victorville, San Bernardino, and Redding). Reconfigurations would add customer service workstations and in some cases, expand parking and lobby space. The offices are all from 25 to 45 years old and renovation would include new heating, ventilation, and air conditioning systems, new floors and modular furniture, etc.

Staff Comment: Renovating and modernizing field offices is a long-term need of the DMV; however, the short-term motivation is preparing for the surge in field office visits that will happen with Real ID. Some of the activities in these BCPs assume new leased facilities will be approved in BCP #4 (above).

Staff Recommendation: Keep open pending additional information and discussion on Real ID.

Action: Issue kept open.

5. **Headquarters Seismic Retrofit / Asbestos Abatement Project (CO BCP #1).** The Administration requests $84.6 million to complete the reconstruction of the Sacramento headquarters building. Last year the Legislature approved $2.2 million for working drawings and the construction phase of the project was estimated at $50 million. The construction phase of the project is now estimated at $82 million. This request is part of a multi-year project – funding for asbestos abatement has been funded in the past several budgets. The early phases of this project began prior to Real ID, and it is unrelated to Real ID.

Staff Recommendation: Approve this request.

Vote:

Action: Approved BCP on a 3-0 vote.

6. **Credit Card Processing Fees (BCP #5).** The Administration requests an augmentation of $11.4 million in 2007-08 and $12.7 million in 2008-09 to continue the payment of credit and debit card processing fees. In 2005-06, the Legislature approved two-year limited-term funding for DMV to pay these processing fees. At times in the past, the DMV has charged customers “convenience fees” to cover the cost of processing fees. Funding was provided in 2005-06 to eliminate these convenience fees to encourage customers to pay with a credit card and reduce visits to DMV offices. The DMV believes that reduced field-office visits save the state about $1.2 million annually – this gross savings was included in the 2006-07 budget. The DMV acknowledges a net cost related to credit card processing fees (about $10.2 million in 2007-08), but feels this is the cost of providing a customer service that Californian’s expect and want.

   Staff Comment: Real ID would require driver-license holders to come to DMV field office to verify identity and therefore would reduce the incidence of driver-license renewals over the internet with a credit card. DMV indicates the impacts of Real ID are not factored into this request.

   Staff Recommendation: Keep open pending additional information and discussion on Real ID.

Action: Issue kept open.

7. **Information Technology Modernization (BCP #1).** The Administration requests 2007-08 funding of $23.9 million (various special funds) and 25.2 positions for the second year of an information technology modernization project with a total cost estimated at $242 million. Last year, the Legislature approved funding of $2.1 million and 5 positions for the first year of this project. While the BCP is not explicit on this point, the DMV indicates that the current request is intended to cover the remainder of the project – so additional Legislative approval would *not* be requested via future BCPs.

Detail / Background: The DMV indicates it will take a multi-year incremental approach with "modular" progress – the intent is to migrate existing functions over to the new system over time such that some benefits are realized prior to full implementation, and risk is reduced. The incremental program would involve the separate migration of the drivers' license database and then the vehicle registration database. The new database would maintain a link to the old while several hundred software systems that need to be updated are shifted from the old to the new database.

Staff Comment: The modular approach to this project (which may mitigate risk) is partly motivated by an unsuccessful DMV IT modernization project in the mid-1990s. If project costs escalate, or if implementation problems arise, the Legislature could decide to limit funding and direct the DMV to re-scope the project to focus, for example, on just the drivers' license database. In approving first-year funding of $2.1 million, the Legislature added an annual January 31 reporting requirement. The DMV has submitted this year's report, but there is not much detail to report because the Department is still in the procurement phase of the project.

Staff Recommendation: Keep this issue open. There are likely to be further discussions on statewide IT policy in the Subcommittee. These discussions may provide additional insight on IT project oversight and management.

Action: Issue kept open.

2720 California Highway Patrol

The mission of the California Highway Patrol (CHP) is to ensure the safe and efficient flow of traffic on the state's highway system. The CHP also has responsibilities relating to vehicle theft prevention, commercial vehicle inspections, the safe transportation of hazardous materials, and protection and security for State employees and property.

The Governor proposes $1.831 billion in total expenditures (no General Fund) and 11,012 positions for the CHP, an increase of $150.1 million (9 percent) and 325.7 positions.

Issues Proposed for Consent / Vote-Only

1. **Personnel Transaction Unit – Staffing (BCP #3).** The Administration requests an augmentation of $728,000 (Motor Vehicle Account) and 10.0 new positions (8.0 Personnel Specialist positions and 2.0 Personnel Supervisor positions) to address increasing personnel workload associated with employee growth at CHP.

2. **Fatality Analysis Reporting System Unit - Staffing (BCP #5).** The Administration requests an augmentation of $112,000 (federal funds) and 2.0 Program Technician positions to meet federal highway accident reporting requirements. The National Highway Transportation Safety Authority (NHTSA). CHP staffing has not kept pace with the growth in fatal accidents and new data requirements. The NHTSA would fund the cost of these positions.

3. **Cargo Theft Interdiction Program - Staffing (BCP #8).** The Administration requests an augmentation of $632,000 (Motor Carrier Safety Improvement Fund), 2.0 new CHP Officer positions, and additional overtime authority to conduct additional investigations and inspections related to cargo theft.

4. **Administrative Costs: Services Provided to the BT&H Agency (BCP #10).** The Department requests reimbursement authority of $180,000 (Motor Vehicle Account) to fund the permanent extension of 2.5 limited-term positions at the CHP that perform administrative work for the Business, Transportation, and Housing Agency. In addition to the two limited-term positions, the CHP currently has 5.0 permanent positions that also perform administrative functions for the Agency. The Agency has BCP #9 that ties to this request.

5. **Highway Work Zone Enforcement (BCP #11).** The Administration requests an ongoing increase in reimbursement authority of $554,000 (from the State Highway Account) for enforcement workload related to the Maintenance Zone Enhanced Enforcement Program (MAZEEP). The program is designed to enhance the safety of California Department of Transportation (Caltrans) workers and contractors while they perform road maintenance activities. The proposed Caltrans budget (BCP #3) includes a concurrent augmentation for the cost of this program.

6. **Office of Internal Affairs.** The Governor requests $952,000 in reimbursement authority and 5.0 two-year limited-term positions to respond to the unfunded workload brought about by requests for investigative services from outside agencies. The Department indicates State departments frequently call upon the CHP to conduct independent reviews and investigations. Investigations are normally approved by the Business, Transportation and Housing Agency and the Governor's Office. The external investigations can consume up to 85 percent of the Investigation Unit's resources and in these cases leave minimal resources for internal investigations.

Staff Recommendation: Staff recommends approval of these consent / vote-only issues.

Action: All issue on consent / vote-only approved on a 3-0 vote.

Issues Proposed for Discussion / Vote:

7. **Enhanced Radio System (Required Report).** The budget includes $108 million for the 2007-08 cost of upgrading the CHP's public safety radio system. Last year, the Legislature approved this five-year project that has total costs of $494 million. The project will enhance radio interoperability with other public safety agencies and provide additional radio channels for tactical and emergency operations. As part of last year's project approval, the Legislature required annual project reporting for the life of the project – the first report was due March 1, 2007.

   Background / Detail: The total projects costs are likely to change because the Department of General Services relied on a survey of existing equipment, instead of a full inspection of the many remote facilities. The report should include updated cost information per the requirements of the budget bill language.

   Staff Comment: At the time this agenda was finalized, the CHP had not submitted the March 1, 2007, report.

   Staff Recommendation: Keep this issue open pending receipt of the report and analyses of the new costs estimates.

Action: Issue kept open. The CHP will provide the report soon.

8. **Officer Staffing Augmentation (BCP #1).** The Governor requests $17.5 million ($21 million ongoing) to add 50 uniformed positions and 41 support staff (an additional 70 uniformed positions would be added in 2008-09 for a total increase of 120 Officers). Last year, the Legislature approved a staffing increase of 310 positions (240 Officers and 70 supervisory and non-uniformed support staff) to be phased in over two years (the 2007-08 phase adds 75 Officers). The CHP indicates this increase would help address the continual increase in workload associated with population growth throughout the state.

   Detail / Background: The need for additional CHP officers is supported by CHP data and prior-year LAO findings. According to the LAO, additional staffing is particularly necessary to CHP divisions that have seen recent large increases in vehicle registrations and highway travel. In addition, the LAO points out that the pace of growth for vehicle collisions throughout the divisions have far outpaced officer hiring between 2000 and 2004.

   LAO Recommendation: In the *Analysis of the 2007-08 Budget Bill*, the LAO recommends that the new positions be approved, but that the requested funding be reduced by a total of $1.1 million to correct technical errors and reduce some costs assumptions.

   Staff Comment: Staff understands the Administration concurs with the $1.1 million adjustment suggested by the LAO.

   Staff Recommendation: Keep this issue open pending receipt from the Business, Transportation, and Housing Agency of a long-term Motor Vehicle Account (MVA) fund condition statement. This information will aid the Legislature in evaluating the ability of the MVA to fund this new ongoing commitment. (See also issue #6 in the Business Transportation and Housing Agency section of this agenda).

Action: Issue kept open. The BT&H Agency will provide additional information on the MVA.

9. **Motor Carrier Safety Program (BCP #7 & Trailer Bill Language).** The Governor requests a permanent increase of $7.7 million to augment staffing 67.9 positions (60 Motor Carrier Specialists and 11.5 support positions). The Administration indicates this will allow the Department to complete 100 percent of the Biennial Inspection of Terminals (BIT), instead of the current 58 percent inspection rate. Motor Carrier Specialists visit terminals to: (1) inspect maintenance and inspection reports for buses and trucks; (2) inspect a sample of required driver records; and (3) investigate hazardous materials handling practices. The Department indicates that statute requires fees to be set at a level to fund the program; however, currently the Motor Vehicle Account (MVA) subsidizes $2.1 million of the cost. Trailer bill language is requested to increase fee levels for motor carriers to pay the full program cost.

   LAO Recommendation: In the *Analysis of the 2007-08 Budget Bill*, the LAO indicates that increased inspections and the move toward self-financing make sense, but that the fee structure is flawed. The LAO recommends that the Administration develop a more rational fee schedule and that only 32 of the requested 71.5 positions be approved. This recommendation would reduce the funding requested by $3.3 million – to $4.4 million. The LAO also suggests that the Administration should advise the Legislature on operational efficiencies it can implement to reduce the time it takes to complete a terminal inspection.

   Staff Comment. The Administration indicates it is revising its fee schedule proposal. At the time this agenda was finalized, the Administration has not provided the revised proposal.

   Staff Recommendation: Keep this issue open pending the receipt and examination of the new fee schedule. Direct staff to work with the Administration and the LAO on the appropriate staffing level and fee structure.

Action: Issue kept open pending receipt of new fee schedule and efficiency response.

10. **State-Owned Facilities – New Construction (CO BCPs 2, 3, 4, 9).** The Administration requests an augmentation of $8.1 million for three major capital outlay facilities projects – two projects are in the working-drawings phase (Oceanside Area Office [$1.1 million] and Oakhurst Area Office [$636,000]) and would likely come forward with construction funding requests in 2008-09 totaling about $21 million; a third project is in the construction phase (San Diego Area Office [$6.2 million]) and involves the renovation of an existing office. Additionally, the Administration requests $225,000 for various capital outlay studies.

    Staff Recommendation: Keep this issue open pending information from the Administration on the long-term fund condition of the Motor Vehicle Account.

Action: Issue kept open. The BT&H Agency will provide additional information on the MVA.

11. Leased Facilities – Relocation of CHP Headquarters (BCP #4). The Administration requests an augmentation of $8.3 million ($7.4 million ongoing) for moving costs and higher lease costs at a new consolidated CHP headquarters. Of the amount requested, $232,000 would cover higher lease costs at two smaller southern California facilities.

Staff Recommendation: Keep this issue open pending information from the Administration on the long-term fund condition of the Motor Vehicle Account.

Action: Issue kept open. The BT&H Agency will provide additional information on the MVA.

12. Budget Funding for Tactical Alerts (LAO Issue). The Governor's Budget includes $24.8 million to pay overtime in the event of tactical alerts. Following September 11, 2001, CHP officers were placed on 12-hour shifts, or "tactical alerts," to enhance preparedness. In 2002-03, the Legislature provided a budget increase of $32.5 million to fund further tactical alerts and adopted budget bill language requiring that any unused funds revert to the Motor Vehicle Account.

Background / Detail: In 2003-04, the Administration reduced tactical alert funding through a baseline adjustment by a reduction of $5.9 million and a redirection of $1.8 million to cover workers' compensation costs. Additionally, the Administration removed the budget bill language that reverted the unspent amounts. In 2002-03, the CHP expended $17.4 million for tactical alerts and in 2003-04 it expended $3.2 million. Since 2003-04, the CHP has not tracked tactical alert costs.

LAO Recommendation: In the *Analysis of the 2007-08 Budget Bill*, the LAO recommends that the Legislature reduce the budgeted funding for tactical alerts by $19.8 million – to $5.0 million. Further, the LAO recommends budget bill language to revert any unused portion of the $5.0 million.

Staff Recommendation: Keep this issue open and direct staff to continue to work with the Administration and the LAO to determine the appropriate level of tactical-alert contingency funding and draft budget bill language.

Action: Issue kept open for further discussions.

13. Workers' Compensation Fraud - Sacramento DA Report (Informational Issue). Media attention in 2004 raised questions of workers' compensation fraud and abuse with certain claims, and questioned the CHP's high rates of claims and industrial disability retirement. In response to concerns, the CHP reinstituted its Workers' Compensation Fraud Unit, among other efforts. In January 2007, the Sacramento County District Attorney (DA) issued a report concerning their investigation of three CHP workers' compensation cases.

Background / Detail. According to the Department of Personnel Administration website, the CHP incurred $60.2 million in workers' compensation costs in 2005-06 – down $4.7 million from 2004-05. Additionally, the rate of uniformed staff retiring on industrial disabilities has historically been higher than statewide public safety personnel as a group in the Public Employees' Retirement System. The CHP's most recent report on workers' compensation and disability retirement (for the period January through June 2006) indicates that there was a 21.4 percent reduction in the number of new workers' compensation claims filed compared to the same period in 2004 (from 1,230 to 967), and that since January 2005, six CHP chiefs have retired with none claiming industrial disability retirement.

Most State departments are "self-insured" for workers compensation costs. The Department of Personnel Services negotiates a Master Agreement with the State Compensation Insurance Fund (SCIF) to administer claims for self-insured state departments.

Sacramento County District Attorneys Office Findings (Staff Issue). The CHP Workers' Compensation Fraud Unit identified several suspicious claims involving high ranking individuals. To avoid the potential for conflicts of interest, Commissioner Mike Brown referred these open investigations to the Sacramento County DA. The DA found that "*After a review of the provable facts and the applicable law, it is our conclusion that although abuses of the system did take place, a criminal case cannot be proved.*" The following are some additional Sacramento DA findings or conclusions:

> *The workers' compensation system, as it was administered by the California Highway Patrol in these cases involving its top management, was riddled with opportunities for abuse and misuse. The situation was compounded when one outside agency, the State Compensation Insurance Fund, which is charged with acting as an independent safeguard, essentially ceded this function to the CHP.*
>
> *Our investigation revealed that CHP repeatedly ignored its own departmental policies, and both the CHP and the State Compensation Insurance Fund failed to follow the Master Agreement that was intended to provide both departments with guidelines on how to handle workers' compensation cases for CHP personnel. The result was that CHP could*

use the worker' compensation system as a tool to deal with problematic employees.

Staff Comment: The Subcommittee may want to ask the CHP how it has revised its procedures to correct for the following problems detailed in the Sacramento DA's report:

- Workers' compensation benefits were paid to an employee prior to authorization from SCIF, contrary to the requirements of the Master Agreement.
- Direction was sent through unattributed "chain of command" in several instances. The DA could not locate the decision maker. Individuals within the chain of command either denied passing the direction along, or were unable or unwilling to recall any specific conversations.
- The CHP did not provide certain documents requested by SCIF, contrary to the requirements of the Master Agreement.

Staff Recommendation: Information issue – no action is necessary. The Subcommittee can discuss this issue further at future hearings as warranted.

Action: Informational issue – no action taken.

8420 State Compensation Insurance Fund

The State Compensation Insurance Fund (SCIF) is a self-supporting, non-profit State entity that provides workers' compensation insurance to California employers at cost with no financial obligation to the public. In addition to being an insurance provider for California businesses and local governments, SCIF acts (under contract) as the workers' compensation administrator for State agencies. Currently, SCIF has a 30-percent market share of workers' compensation insurance policies in California – down from a peak of 60 percent earlier in the decade.

The Governor's Budget indicates $4.150 billion in SCIF expenditures (Compensation Insurance Fund) and 6,768 positions, an increase of $107 million and a decrease of 1,170 positions. The budgeted figures include State workers' compensation costs, SCIF administrative costs, and benefit payments for private and local government entities that are insured through SCIF. SCIF funds are continuously appropriated in statute, and therefore no appropriations are included in the annual budget bill. The cost to the State for providing workers' compensation benefits for State employees is estimated by SCIF to be $455 million in 2007-08, down about $5 million from the 2006-07 estimate (and down $71 million, 14 percent, from the 2003-04 figure).

Issues for Discussion

1. **Overview of SCIF's Budget (Informational Issue).** SCIF's funds are continuously appropriated and not included in the annual budget bill. The Governor's Budget display includes all SCIF expenditures including those expenditures related to coverage purchased by businesses and local governments. The cost to the State for state employees' workers' compensation is displayed in the SCIF budget item, although actual budget authority is provided in the budgets of individual State departments, who reimburse SCIF as costs are incurred. The table below shows the change in State workers' compensation costs from the peak in 2003-04 through SCIF estimates for 2007-08.

	2003-04	2004-05	2005-06	2006-07*	2007-08*
SCIF Admin Costs	$53.6	$56.1	$60.7	$68.0	$72.0
Cost of Benefits	$473.6	$439.5	$398.3	$392.1	$383.5
Total State Costs	**$527.2**	**$495.6**	**$459.0**	**$460.1**	**$455.5**
Total New Claims	31,102	25,546	26,095	26,500	27,030

* SCIF estimates

Over the five-year period (including estimates for 2007-08), the cost of direct benefits has fallen by 19 percent and the number of new claims has fallen by 13 percent. SCIF administrative costs have increased by 34 percent. Overall State costs are estimated to be 14 percent less in 2007-08, than actual costs in 2003-04.

Staff Comment: The Subcommittee may want to ask SCIF the following (The Department of Personnel Administration has also been asked to attend the hearing and be available to respond to questions that are better directed to them):

- Why have administrative costs increased by 34 percent (projected) while direct benefit costs and the number of new claims has fallen?
- How does SCIF determine the appropriate staffing level for State workload, and determine appropriate metrics such as the number of claims per adjuster?
- What is the process and timeline over the next few months for determining final 2007-08 administrative costs in coordination with DPA?

Staff Recommendation. This is an information item and no action is required. The Subcommittee may want to direct staff to follow the process over the next few months as SCIF and DPA finalize 2007-08 administrative costs for State workload. Staff can inform the Subcommittee if costs change significantly from the figures included in the Governor's Budget.

Action: Issue kept open – SCIF will provide additional information on the drivers of the higher administrative costs, and statistical data related to the age of claimants.

2. **SCIF Administration of Workers' Comp for State Agencies.** The Department of Personnel Administration (DPA) contracts with SCIF (via the "Master Agreement") to provide workers' compensation administrative services to the majority of state departments that are self-insured and to provide insurance coverage to the small number of state departments that are not self insured. Most workers' compensation benefits are directly paid by SCIF (and then SCIF bills departments), but other benefits are directly paid by individual departments. The budget estimates State workers' compensation costs in 2007-08 will be $455 million, with $72 million of that being administrative costs charged by SCIF under the Master Agreement. A recent Sacramento District Attorney's Office investigation of workers' compensation fraud at the California Highway Patrol (CHP) raised questions about the role of SCIF and the role of individual State departments in administering the workers' compensation benefits to State employees (See also issue #13 under the CHP section of this agenda).

   Assigned Responsibilities under the Master Agreement. Section III of the Master Agreement lists responsibilities of SCIF, individual State departments, and DPA. Below are some responsibilities that relate to investigating and reducing workers' compensation fraud:

   SCIF Responsibilities:

   07. State Fund shall determine whether an injured employee is entitled to workers' compensation benefits based on the medical record and relevant facts.

06. State Fund shall notify the Return-to-Work Coordinator (RTWC – a department representative) when there is a need for a comprehensive investigation.

Individual State Department Responsibilities:

05. The department RTWC and department employees shall cooperate with the State Fund attorneys and the investigators they assign when the need arises for a claim or fraud investigation.
14. The RTWC shall report any suspected fraudulent activity to a State Fund's representative of the State Fund office adjusting the claim.

Department of Personnel Administration Responsibilities:

01. DPA *may* provide a review, upon request, of the performance of State Fund or a State department with regard to the terms and conditions of this contract.
02. DPA *may* conduct random annual verifications of compliance of the departments participating in the Master Agreement. These verifications of compliance may include a random sampling, as specified.

(Note, the DPA indicates it has not conducted a review or verification in at least 6 or 7 years. DPA indicates reviews in the past were not deemed productive, and staffing cuts and workload growth have limited the ability of DPA perform this function.)

Sacramento County DA Report. As discussed in the CHP section of this agenda, the Sacramento DA indicated that neither the CHP nor SCIF was living up to their responsibilities under the Master Agreement. In one case, workers' compensation benefits were paid prior to authorization by SCIF. In another case, a SCIF claims manager asked for a personnel file in order to substantiate reports of an internal affairs investigation and the file was not provided nor was any SCIF follow-up noted.

Suggested Questions: The Subcommittee may want to ask SCIF the following:

- How can workers' compensation benefits (Industrial Disability Insurance or Labor Code Section 4800 benefits for the CHP) be paid by the Controller prior to SCIF verification of injury?
- What does SCIF do when departments fail to provided requested documents?
- Does the Master Agreement require SCIF to report any non-compliance by departments to the DPA?

Staff Comment: Staff discussions with SCIF and DPA reveal what appear to be gaps in State oversight of the workers' compensation system for State workers.

- The Master Agreement does not require SCIF to report the failure by a department to fully cooperate and provide required documentation to SCIF. Therefore, it appears SCIF does not report all issues concerning departmental non-compliance to DPA?
- Departments are required to receive authorization from SCIF prior to submitting requests for Industrial Disability Insurance benefits to the State Controller for payment. The Sacramento DA found the CHP had submitted requests to the

Controller prior to approval by SCIF. There does not appear to be any mechanism in place to monitor or audit this practice (since DPA no longer performs reviews or verification of departments' compliance with the Master Agreement).

Staff Recommendation. Keep this issue open. Direct staff to work with the Administration on mechanisms for providing oversight of how state departments meet their requirements under the Master Agreement. Direct staff to work with DPA on how SCIF reporting requirements could be improved with a future Master Agreement to requiring reporting on non-compliance.

Action: Issue kept open, SCIF and DPA will provide additional information on any actions they propose to take to address the oversight deficiencies outlined in the agenda.

Attachment I

Bureau of State Audit Highlights for Department of Corporations Audit

California State Auditor/Bureau of State Audits
Summary of Report 2005-123 - January 2007

Department of Corporations:
It Needs Stronger Oversight of Its Operations and More Efficient Processing of License Applications and Complaints

AUDIT HIGHLIGHTS

Our review of the Department of Corporations' (Corporations) operations revealed the following:

- *Corporations' current fee structure results in certain licensees subsidizing the administrative costs for others. For example, revenues from securities fees have exceeded the related service costs by $22.2 million over the last seven years.*
- *Corporations has taken important steps in strategic planning for its operations, however, these efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports.*
- *Corporations does not always process applications within the time limits set by state law. In fact, for applications submitted between January 2004 and May 2006, the average processing time exceeded the time allowed by law for many of the application types we reviewed.*
- *Although there is no legal requirement dictating the length of time Corporations has to resolve complaints, we found examples of unneccessary delays in a sample of complaints we reviewed.*
- *Corporations has three primary information systems for capturing complaint related data; however, none of them are reliable for determining the number, type, and status of its complaints because the systems contain too many blank fields, duplicate records, and errors.*
- *Corporations did not conduct required examinations of at least 170 licensed escrow offices and 899 licensed finance lenders within its four-year goal.*

RESULTS IN BRIEF

The Department of Corporations (Corporations), within the Business, Transportation and Housing Agency, is responsible for licensing and regulating the securities and financial services industries, including businesses such as securities brokers and dealers, investment and financial planners, and certain fiduciaries and lenders. As part of these responsibilities, Corporations issues and renews licenses, examines and investigates licensees, and collects periodic assessments from certain licensees. Corporations is supported solely by the fees and assessments it collects. Although it also conducts investigations into alleged violations of the laws over which it has jurisdiction, Corporations has typically been required to transfer any fines and penalties it collects to the State's General Fund.

We found that since 2001, Corporations has not analyzed the licensing and examination fees it charges businesses to determine whether the fees matched its costs of providing the related services. As a result, it has consistently overcharged for some activities and undercharged for others. For example, revenues from securities fees have exceeded the related service costs for six of the last seven fiscal years, resulting in excess revenues of $22.2 million from these fees during that time. Corporations has also generated excess revenues from three of the other business activities it regulates. Overall, excess revenues from these three activities have totaled $2.8 million over the last seven fiscal years. In contrast, the revenues generated from fees for nine other business activities have not been enough to cover the service costs, falling short by a total of $21 million over the last seven fiscal years. For example, the fees charged to process applications for businesses providing investment advice have not been high enough to cover Corporations' costs of providing these services, falling short by $8.2 million during this time. In effect, the excess revenues generated from some types of fees allow Corporations to offset the funding shortfalls for the services it provides for other applicants. Some of the fees collected by Corporations, such as licensing fees, are generally set by statute and thus cannot be raised without a change in the law. However, state law has given Corporations the authority to set certain fees below the statutory amount.

Similarly, Corporations has not recently updated its billing rates for audits and examinations. Our audit found that Corporations' Financial Services Division would have generated more than $1 million in additional revenues from examinations during the period from January 1, 2004, through May 23, 2006, had it revised its billing rates to reflect its increased employee costs for examiners.

Any excess revenues not used by Corporations to fund its operations and not transferred or loaned to other funds accumulate in the State Corporations Fund. These accumulated excess revenues may result in a violation of a state law that takes effect on June 30, 2007, which requires Corporations to limit the reserve it maintains in the fund to 25 percent of annual expenditures, or approximately $8 million by that date. Corporations stated that its reserve was $13.1 million on June 30, 2006; however, this amount does not take into account a loan to the General Fund of $18.5 million, $6 million of which Corporations' financial management chief expects to be paid back in fiscal year 2006-07. If Corporations does receive the $6 million loan repayment in fiscal year 2006-07, it would have to spend $11.1 million more than it collects in that year in order to reduce the State Corporations Fund to the statutory maximum. Given that Corporations has not changed any of its fees and had excess revenues totaling $3.2 million in fiscal year 2005-06, that does not seem to be a reasonable expectation.

Corporations has taken important steps in strategic planning for its operations, seeking to identify its strengths and weaknesses, eliminate inefficiencies, and increase productivity. It is also in the process of implementing a program-level action plan. However, these efforts are undercut by inaccurate statistical information about its actual performance as reported in its monthly and quarterly performance reports. Such errors, if they are significant, may direct Corporations' attention away from important issues needing improvement or toward lesser issues at the expense of areas of greater concern. The inefficient methods used to compile the performance reports also consume time that could instead be used to complete the tasks the reports are measuring. The performance report for the quarter ending September 30, 2006, indicates that Corporations has fallen short of most of its goals.

In addition, because it does not gather sufficient data and does not always identify benchmark goals for its performance measures, the effectiveness of Corporations' Education and Outreach Unit (outreach unit) is uncertain. For example, the outreach unit does not collect data for four of the 12 performance measures it has identified for its Seniors Against Investment Fraud Program. Further, of the eight performance measures for which it does collect data, it has established benchmarks for only two. Without sufficient data and benchmarks, it is impossible for Corporations to effectively assess the value of its efforts. Similarly, Corporations did not have any goals for its Troops Against Predatory Scams Investor Education Project.

Corporations does not always process applications within the time limits set by state law. In fact, for applications submitted between January 2004 and May 2006, the average processing time exceeded the time intended by law for many of the application types we reviewed. Although Corporations is responsible for some of the delays in processing license applications, other factors outside of its control also contribute to lengthy processing times. For instance, applicants frequently submit incomplete applications that require Corporations to issue deficiency notices. In fact, we found several instances in which Corporations had to send applicants multiple deficiency notices before it obtained the information needed to rule the applications complete. Furthermore, applicants do not always respond promptly to the deficiency notices. Delays in processing are detrimental to the applicants because they prevent applicants from conducting business.

Corporations also did not always resolve complaints related to securities regulation and financial services as quickly as it could have. Although there is no legal requirement dictating the length of time Corporations has to resolve complaints, our review of 20 complaints related to securities regulation identified four complaints in which unnecessary delays increased the length of the process. In one instance, the Securities Regulation Division did not begin its investigation until 277 days after the complaint was received. We found similar unnecessary delays in Corporations' handling of our sample of 20 financial services complaints. When Corporations does not investigate complaints promptly, its ability to protect consumers from fraudulent activities is compromised.

Furthermore, the information systems used by Corporations to track complaints are unreliable because they contain a large number of blank fields, duplicate entries, and inaccuracies. Fields commonly left blank include the date a complaint was received, the date the case was opened, the type of law involved, and the name of the staff member assigned to the complaint. In addition, one system listed an incorrect status for many of the complaints we reviewed. Consequently, it is difficult, if not impossible, for management to use these systems as tools for assessing some of Corporations' activities.

Corporations' Enforcement and Education Division (enforcement division) also did not always identify a reason for rejecting complaints, and for the cases for which it did identify a reason, it did not always fully document its rationale. Because the enforcement division cannot fully investigate every complaint it receives, due to its workload and budget constraints, its policy is to occasionally reject some lower-priority complaints, such as complaints involving out-of-state complainants or those involving a limited number of investors. However, to ensure that the process of rejecting complaints is consistent and fair, the enforcement division should carefully document its rationale for doing so in each case.

Corporations has recently modified its procedure for handling complaints. In addition to developing formal policies for rejecting and referring complaints, it has centralized the intake of all complaints into a new complaint team. Corporations believes that this new process will allow it to respond immediately to complaints and prepare each complaint for referral to the appropriate division. Because Corporations initiated this process near the end of our field work, we were unable to test whether it will correct any of the weaknesses we identified. However, it appears that the process contains good business practices.

Finally, contrary to law, Corporations has not conducted at least 170 (37 percent) of its required examinations of escrow office licensees within the last four years. In addition, it has yet to conduct examinations for 899 (35 percent) of eligible finance lender licensees within its four-year goal. According to Corporations' action plan, its examinations have the potential to detect violations of the law and unsafe, unsound, or abusive practices and serve to deter potential wrongdoing. Thus, having a significant examination backlog could leave consumers less well protected.

RECOMMENDATIONS

To strengthen its operational oversight, Corporations should seek legislative authority allowing it to set fees by regulation. This legislative authority should require that Corporations annually assess its fee rates and establish fees that are reasonably related to its cost of providing the services supported by its fees. Corporations should also factor in the amount of any excess reserves when conducting its annual assessment.

To improve the efficiency and effectiveness of its system for collecting actual performance measure information, Corporations should do the following:

- Consider assessing the need for new automated data systems or determining whether its current systems are capable of collecting the necessary information.

- Ensure the accuracy and completeness of the information in its automated systems by requiring staff to enter the information and requiring supervisors to review it periodically. For data not currently available in automated format, Corporations should develop stronger procedures to ensure that staff accurately report and supervisors review the information. Corporations should consider calculating and reporting performance measures quarterly, rather than monthly, until it has a more efficient data collection system.

To ensure that it has identified all necessary performance measures and appropriately focused its current performance measures, Corporations should continue to assess the reasons for performance deficiencies and add or adjust performance measures as needed.

To ensure that the outreach unit can effectively measure its success, Corporations should ensure that it collects all of the necessary data and establishes reasonable benchmarks.

To ensure that all applications are reviewed promptly and sufficiently, Corporations should do the following:

- Continue to monitor the progress of applications through the review and approval process to identify any that have stalled, and investigate the reason for the delay.

- Follow up with applicants that do not promptly respond to deficiency notices.

- Assess whether it needs additional staff to process applications.

- Maintain all necessary data in its information management systems so that it can effectively calculate the number of days it takes to process applications.

To improve the efficiency of its complaint-handling process, Corporations should do the following:

- Develop procedures to track the progress of complaints to ensure that they continue to move through the process without unnecessary delay.

- Monitor its newly established complaint-referral process and develop procedures, if necessary, to decrease the length of time it takes to refer cases to the appropriate division.

- Review its existing complaint records and eliminate duplicates and correct any inaccurate fields. Further, Corporations should maintain accurate and complete data to ensure that the information systems can be used more effectively as management tools.

Corporations should develop a plan to conduct examinations of licensees in accordance with state law and its own internal policy.

AGENCY COMMENTS

Corporations did not have any substantial disagreements to our report and found the recommendations to be useful. The Business, Transportation and Housing Agency concurred with Corporations and stated that the report should prove to be a useful blueprint for Corporations' recently appointed commissioner.